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THE DEPUTY SECRETARY OF THE TREASURY

WASHINGTON, D.C. 20220

MAR 15 1974

Dear Ken:

In my letter of March 7, 1974 I promised further explanation of our position on the deep seabed. You will recall I proposed negotiating a Seabed Organization which has no regulatory authority at all, but which instead is a forum for consultation, for registering claims approved by national states, for collecting and making available to its members information on the development of the seabed and for keeping track of the revenue payments of national states. All regulatory authority would be in the hands of the national states, through domestic legislation. The states would commit themselves in the treaty to recognize, on the principle of reciprocity, claims of other states.

I have enclosed two brief papers which illustrate what we have in mind. The first sets out provisions which should be in the Law of the Sea Treaty and which would establish the limitation of the organization's authority and the rights and obligations of National States. The second paper sets out a preliminary approach to what an appropriate piece of domestic legislation for the United States might be.

Let me stress this second paper is tentative and illustrative. I recognize that its provisions will seem a bit sparse to some. Much more work has to be done on it, and I would not expect to discuss it at length in our meeting. My concern at this point is that we get to work on this legislation in the most appropriate forum. Perhaps our thoughts could form one basis for this work.

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We should in the meeting, however, spend some time on the ISRO treaty provisions issue. Timing as well as content are important.

The approach we lay out derives from our interagency experience with drafting detailed rules to go into a treaty, and our reading of the mood of the developing countries as we approach Caracas.

The Interagency Task Force believes that the rules, to be acceptable, must leave no discretion in the hands of the ISRA. We certainly agree. Should this institution have the power to decide fees, royalty rates or operating regulations, we are in trouble. The Task Force solution is to spell out in the treaty detailed provisions which the ISRA would be bound to observe. Given the difficulty our own people are having agreeing on specific rules, we think it is unrealistic to expect 150 countries to agree on the exact rules and numbers to go into a treaty. If we go this route, we expect that after weeks of debate on the appropriate numbers, the overwhelming consensus will be to leave these "technical questions" up to the new organization, and we will have negotiated ourselves into the very position we all are agreed we should avoid. Is it not more sensible to move now, well before Caracas, and before other countries are locked into negotiating positions, to lay out the positions we can accept?

I would hope that as a result of our meeting, we can agree:

1) That the U.S. should adopt the seabed approach I propose.

2) That this approach should be presented to the group of five meeting in late April, and wherever else might be appropriate before then. I should think we would want to send instructions to all our key LOS Embassies to make approaches to their host governments. We think it important that there be no ambiguity about what the U.S. position is.

3) That we should get on with drafting an administration bill for regulating deep seabed mining for enactment by the Congress sometime early in the next session of Congress.

Sincerely yours,

William E. Simon

The Honorable
Kenneth Rush
Deputy Secretary of State
Department of State
Washington, D.C. 20520

Enclosures

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

MAR 7 1974

Dear Ken:

Several developments in the interagency work on Law of the Sea issues are coming to a head at one time and they seem to me to make it imperative that we have a session, or perhaps more than one, of your Undersecretaries Committee. Accordingly, I wish to propose that you get us all together as quickly as you can after your return to the office next week.

The issues I have in mind are these:

1) Implications of The Economic Review. This Review has now been completed and the Task Force has filed it with you. It is a very thorough report, it seems to me, and we should look it over carefully to see whether we wish to instruct the drafters of NSSM on Instructions for the Caracas conference to pay particular attention to some of its results. For example, the finding that "without reference to political or other non-economic factors there are no significant economic conditions requiring that a legal order for the deep seabeds include an international authority which would manage the development of deep seabed resources," is very important, and the implications of this statement should be explored.

2) Rules and Regulations for an ISRA. I understand that we are committed to the Group of Five to have a new draft of rules and regulations for the proposed International Seabed Resource Authority ready for discussion in that group by late April. There has already been a fair amount of slippage in the timetable for this meeting because of controversy among the agencies over what these redrafted rules should be. Guidance from us will help the task force to prepare these rules.

One question which has bothered us for some time is the extent to which putting any rules forward might prejudice our withdrawing the ISRA proposal should we subsequently wish to do so. Another very important question is whether the rules which our economists feel we could tolerate are in

fact negotiable. For example, the drafters believe that the rules to be acceptable must leave no discretion in the hands of the ISRA. I agree. Should this institution have the power to decide fees, royalty rates, or operating regulations, we can expect it will use them to our detriment. Up to now, the drafters' solution has been to spell out in the treaty any such provisions, which the ISRA would be bound to observe. But is it realistic to expect that nearly 150 countries can agree on exact numbers to go into the treaty? Isn't it more reasonable to expect that after weeks of debate, the overwhelming consensus will be to leave these "technical decisions" up to the new organization? And where will this leave us? In this connection, I will have some concrete suggestions to put before the group.

3) Domestic Legislation on a Seabed Regime. John Moore has now testified on H.R. 12233, the Deep Seabed Hard Minerals Act, which would empower the administration to regulate mining of the deep seabed. In the testimony we recognized that with or without a LOS treaty, we will need legislation soon to permit us to participate in deep sea mining, and we have promised the Senate and House Committees that we will have substantive comments on their Bill very quickly. There is, naturally, disagreement within the Administration on what the legislation should contain. I think we could save everyone a great deal of time if the Undersecretaries could give the Task Force guidance on what kind of legislation should be drafted, and on how closely and when they should work with the Committees.

I'm sure you see the connection among the above three items. I strongly believe we should work through them now before we get caught up in the very time-consuming process of reviewing the proposed instructions for the Caracas Conference. Those draft instructions will be before us within a few weeks, with or without our guidance. Let me say that as a result of these pressures, our thinking has been moving toward:

a) Pressing forward with domestic legislation which would allow the Administration to license exploration and exploitation of the deep seabed, subject to the reciprocal recognition of the legitimate claims of other countries;

b) Striving in the LOS Conference in Caracas to negotiate a Seabed Authority which has no regulatory authority

at all, but which instead is a forum for consultation, for registering the claims approved by national states, for collecting and making available to its members information on the development of the seabed, and for keeping track of revenue payments of the national states.

c) Making this intention known to the Group of Five in late April in order to work out a coordinated approach at Caracas.

As I mentioned above, next week I will have a more fully developed position on this matter to put before you.

Sincerely yours,

William E. Simon

The Honorable
Kenneth Rush
Deputy Secretary of State
Department of State
Washington, D. C. 20520

The Treaty Provisions

Statement of Treaty Principles

The deep seabed and its resources are the heritage of mankind.

It is in the interest of mankind that the deep seabed be developed, and that States cooperate to this end, in a manner which will

-- foster the healthy development of the world economy.

-- promote the growth of international trade.

-- give particular attention to the needs of the developing countries.

-- protect and conserve the natural resources of the area; prevent pollution and contamination of the marine environment, including the coastline, and interference with the ecological balance of the marine environment; prevent damage to the flora and fauna of the marine environment;

-- have due regard for freedom of navigation and other uses of the ocean.

The development of the deep seabed should be for peaceful purposes.

Treaty Provisions on the Organization

There shall be an international seabed Resources Organization (ISRO) with a council and a secretariat;

The Organization Shall

1) Keep under review the operations of member states in developing the deep seabed and its resources; provide a forum for consultation of member states; and publish annually a report of its development.

2) Receive from member states reports on their operations respecting the deep seabed and communicate them to other member states.

3) Make recommendations (non-binding) to member states respecting the development of the deep seabed.

4) Record the claims by member states for exploration and exploitation of the deep seabed and make such information available to member states.

5) Auction claims when two or more national states claim the same area.

Treaty Provisions on the National States

Nation states shall promulgate legislation or take such other action as is necessary to ensure that their nations operating on the deep seabed do so in accord with treaty principles.

Shall ensure that their regimes at a minimum:

-- provide for exclusive exploration and exploitation privileges for all minerals of the deep seabed.

-- recognize the validity of claims of another member state, subject to appeal to the ICJ if the initial claim is frivolous, and just so long as there is reason to believe the claim will be developed in a reasonable period of time.

-- ensure that the claims of those claimants licensed will reach commercial production in a reasonable period of time.

-- discourage claims which cover exceptionally large areas of the seabed.

-- set out standards and procedures for protecting the marine environment.

-- set out standards and procedures for avoiding conflict with other uses of the ocean, such as ocean navigation and overflight.

Shall:

-- pay ____% of the value of production of any claim it has granted, from such time as commercial production has begun to the World Bank.

-- report to the Organization the amounts of money collected and the basis for their collection.

Shall:

-- report to the Organization promptly, for recording, the grant of each exploration or exploitation privilege and any transfer thereof.

-- publish promptly any laws, regulations, judicial decisions and administrative rulings pertaining to the development of the deep seabed, including claims registered or applied for.

-- administer in a uniform and impartial and reasonable manner all of the laws, etc. mentioned above.

-- collect and publish data obtained from mineral resource developers pertaining to geological structures, the extent of mineral deposits and production from the claims it has granted.

-- publish annually a report on the development activity of its licenses and on its own actions in respect of this convention.

Shall seek to resolve any dispute respecting the development of the seabed through normal diplomatic channels or by referring the matter to the International Court of Justice.

March 14, 1974

An Approach to Proposed Domestic Deep Seabed Mineral Resource Legislation: An Administration Response to HR 12233 -- "The Deep Seabed Hard Minerals Act."

I. Objectives:

The principal objective of this proposed legislation is the legitimization of U.S. firms' rights to explore and exploit the mineral resources of the deep seabed. It strives to create a climate conducive to timely development of these resources and endeavors to promote economically efficient development of the mineral resources to be found on the oceans' floors. To accomplish this, it establishes a system of property rights such that individual resource developers have exclusive mineral resource control over any area they wish to claim, consistent with environmental consideration. At the same time, it seeks to avoid providing special treatment of prospective resource developers as well as potential conflict with the ongoing Law of the Sea Treaty Conference.

II. Scope:

1. The proposed legislation should cover those areas of the sea currently beyond the national jurisdiction of any sovereign state. It should provide for licensing of deep seabed mineral resource developers so that they have exclusive exploration and exploitation privileges to all minerals contained in the specific area or areas of the deep seabed which they have leased.

2. For purposes of this legislation, no distinction is to be made between exploration for minerals and exploitation

of mineral deposits. Nor is any distinction to be made between different types of minerals. A single license and lease will cover both types of activities and all mineral rights within the leased area.

Commentary

This provision promotes the economically efficient exploitation and development of deep seabed mineral resources. It establishes property rights so that the discoverer can, with a high degree of assurance, capture the rewards of discovery. Moreover, since the mineral resource developer has rights to all minerals, he can decide, with guidance of the market system, which resources should receive priority in development.

3. The activity of prospecting, that is, searching within a very large area, requires no license; however, prospecting may not be conducted on those areas of the sea-bed which are already under lease without the permission of the original leasee.

III. Resource Management

1. The Interior Department in conjunction with other appropriate government agencies is responsible for management of the deep-seabed leasing program and for enforcement of environmental standards. Their explicit responsibilities include:

a. Establishing a system of property rights under a non-discretionary first-come, first-served claims registry. That is, they award property rights to licensee specified areas of the deep seabed for purposes of mineral resource development.

b. Conducting cash bonus auctions to determine who should be granted the right to explore and exploit an area when more than one potential developer seeks rights to the same area.

c. Collecting and publishing data obtained from mineral resource developers on geological structures extent of mineral deposits, and production.

d. Determining in coordination with the Environmental Protection Agency appropriate envi on-mental safeguards and enforcing these through the cooperation of appropriate enforcement agencies (e.g., the Coast Guard).

Commentary

This resource management provision because of a) above will tend to insure timely development of deep seabed resources and by virtue of b) will tend to insure that the most efficient firms are awarded the exclusive exploration/exploitation privilege with respect to the former point, this approach will facilitate the development of the lowest cost resource deposits first. Concerning the latter point, cash bonus auctioning tends to favor those firms which can make the greatest profit on development of these resources. Other things equal, efficient firms will generally be able to bid higher amounts for specific areas than will inefficient firms; thus lowest cost producers will tend to win auctions.

It should be noted that if relatively inefficient firms err and bid too much, they can always subcontract to an efficient firm once they discover their error, because the efficient firm will be able to pay the inefficient one more for the exclusive mineral rights than the rights are worth to the inefficient firm. Hence, coupling the provision of b) with free transferability of leases and unlimited subcontracting will tend to assure efficient development by efficient firms.

The scope for discretionary management of deep seabed mineral resources has been minimized in the above list of responsibilities simply because these resources do not require such management, rather all available evidence suggests that private developers, guided by the market system, will make the most efficient decisions. Explicit discretionary responsibility is, however, lodged with the resource manager for environmental purposes. Environmen al considerations pose a dynamic problem, changing with technology, the relative attractiveness of deep sea mining, and so on, hence a flexible approach is desirable.

IV. Leases

1. Firms may apply at anytime for exclusive exploration and exploitation licenses to any area or areas currently not under lease, with no size limitations obtaining. Such licenses are applicable for a twenty-five year period and are automatically renewable at the option of the leasee for a twenty-year period.

2. Rights to all minerals which are contained in the area are covered by a single lease.

3. Leases are freely transferable without the approval, but with the notification, of the Resource Manager. They may also be returned to the Resource Manager at any time.

4. Leasees may freely sub-contract resource development.

5. In the event that two or more claims to the same area are received by the Resource Manager within a given period of time, the Resource Manager will conduct a cash bonus bid auction among the competing firms as the basis for deciding among such claims.

Commentary

Of the above, the only potentially quite controversial provision is the one which sets no maximum claim size--1. Moreover, there is no provision obligating mineral resource developers actually to develop the resources under their control. In other words, there are no anti-monopoly provisions in the proposed approach to domestic legislation.

As noted below under Section V Financial Provisions (specifically, the section dealing with rents) it may be quite expensive for a firm to hold exclusive mineral rights to an area. Hence, there is incentive for firms to develop areas under their control at economically efficient rates. However, scope is provided for those firms who voluntarily seek to conserve these resources for future development if they feel it is economically justified. In addition, since this is domestic legislation U.S. Anti-Trust Law obtains, thus it would be possible to prosecute firms which collude to forestall development in an attempt to manipulate prices.

V. Financial Provisions

1. The Resource Manager will charge a fee of_____ to register a claim. These funds will be used to cover administrative costs for the Deep Seabed Leasing Program alone.

2. Cash bonus bids may, at the option of the leasee, be paid either in a lump sum at the time of the granting of the lease or in equal annual installments over a ____-year period. If the latter option is chosen, the interest rate applicable is the rate prevailing on government securities with a __-year maturity at the time of the granting of the lease.

3. Leases may be returned to the Resource Manager at any time. If this occurs within the ___-year period noted in paragraph 2 above (the period over which installment payments may be made), the leasee is obligated to pay only____percent of the contractual remaining installment payment if the returned area had originally been offered via competitive bidding and if he had chosen to pay in installments. If the leasee chose to make an initial lump sum bonus bid payment, a pro rata share will be returned if lease rights are returned to the Resource Manager.

4. An annual rental fee of ($1.00) per square kilometer of area under lease will be charged to leasees. For years after commercially viable production commences, this fee may be treated as a tax deductible expense, but only against income earned on deep sea mineral resource development activities.

For years prior to the commencement of commercially viable levels of mineral production, fees paid may be cumulated and deducted from income once production begins. That is, they may be carried forward as expenses.

Commentary

This provision provides an economic incentive to reach commercial production sooner rather than later and as such serves as a device which will tend to inhibit firms from claiming exceptionally large areas of the deep seabed with no intention to explore or exploit them.

5. There will be no royalty type of taxation on the development of deep seabed resources.

6. There will be no depletion allowance associated with deep seabed mineral resource development.

Commentary

Royalties are among the most economically inefficient forms of taxation imaginable in that they tend to lead to reduced production of the resource. In particular, they force premature abandonment of mines. That is, as the costs of extraction rise, as they certainly do over time, and the individual operator has no control over price, a royalty on production results in the operator's producing less than he otherwise would have produced. Since the price of the good must cover not only costs, but also royalty payments, the higher the royalty, the sooner production will cease.

Provision for a depletion allowance is not an economically efficient way of encouraging exploration and production, principally because the benefits are of highly uncertain value. If incentives beyond the inherent profitability of deep seabed mineral resource development are sought to promote development at a more rapid than normal pace, direct subsidies would be a better means of accomplishing this.

VI. Relationships with Other Countries

a. Presence of Law of the Sea Treaty

In the event that a Law of the Sea Treaty is negotiated, deep seabed resource development will be conducted in accordance with its dictates.

b. Absence of Law of the Sea Treaty

If a Law of the Sea Treaty is not negotiated, appropriate bilateral arrangements with other countries which have the technological ability to explore and develop deep seabed resources will be necessary.

March 14, 1974